SMALL BUSINESS LEGISLATIVE COUNCIL

On behalf of the Small Business Legislative Council, we use to submit the following comments for the record for the hearing about tax reform and the impact on small businesses.

INTERNAL REVENUE CODE SECTION 179 DIRECT EXPENSING ALLOWANCE

Section 179 allows a business to deduct the expenses for the purchase of equipment and machinery in the year of purchase. The amount of the deduction is limited and the ability to use the allowance is further reduced and eliminated if the total amount of investment in equipment and machinery exceeds a certain amount. The allowance is currently $500,000 and the purchase "cap" is $2 million. At the end of the year, the allowance and cap will revert to the 2003 amounts of $25,000 and $200,000 respectively.

We support making the current temporary amount and cap permanent and indexing them for inflation.

There are three phrases associated with the direct expensing allowance: "cash flow," "simplicity," and "encouraging investment."

If you understand small business, you understand the importance of reliable cash flow. Talk to a small business owner, and you will hear talk of the "monthly nut." The direct expensing allowance allows small business owns to manage their investments and tax consequences in a real time cash flow environment.

The simplicity is obvious when you like at the alternative: depreciation. With a robust direct expensing allowance, you buy it, you pay for it, you report on the tax return and you are done with it. No issue the next year, or the year after or the year after or…

We talk a lot about small businesses' job creation abilities and those come hand and hand with the investment in the resources to grow and meet the demand for your innovations. The direct expensing allowance encourages that investment. We might add the direct expensing allowance is not just about the small businesses that benefit from the ability to use it. Often overlooked are the small businesses that make, distribute, and sell the innovative equipment and machinery that other businesses purchase. The ability to encourage their customers to invest in their equipment and machinery is important to those small businesses.

The modern day version of the direct expensing allowance has its roots in the 1980 White House Conference and passage of legislation in 1981. The amount was $5,000 with a glide path to $10,000 in 1986 that was subsequently disrupted. Later, we got on a new glide path to get us to the $25,000 in 2003. If you dust off documents in the congressional archives, you will find that the Small Business Legislative Council played an active role in securing passage of the 1981 legislation and subsequent efforts to improve it. We would like to finish the job.

CASH ACCOUNTING

The ability for small businesses to use cash accounting has been a long time goal of the Small Business Legislative Council. With our good friends, former Senator Kit Bond and former Representative Wally Herger and former Internal Revenue Service Commissioner Charles Rossotti we worked on this problem in the late 1990's and early 2000's. We were able to make some headway with administrative activity but tax accounting remains one of the banes of small business' existence.

Again, the phrase "cash flow" and "simplicity" come to the forefront. Our tax accounting rules are all about getting the tax revenues to the government as soon as possible. Putting aside the time value of money issue, at the end of the day the government does gets its tax revenues, whether cash accounting, accrual accounting, or capitalization is used. Ironically, it is the methods that get the government the tax revenue the soonest that provide the most complexity for small business.

If you want to match up small business tax accounting with cash flow, cash accounting is the option that fills the bill. Cash in, cash out. Buy or make goods, sell the goods.

If you want to match up small business tax accounting with simplicity, cash accounting fills the bill. Cash in, cash out. Buy or make the goods, sell the goods.

You just have to get over the tax revenue deferral transition and the government gets it money either way.

However, if you want to truly claim a simplicity victory, we have to deal with inventory accounting. For most small businesses, inventory accounting is what creates the complexity. Some industries may have other issues that defer expenses but it is the inventory accounting that provides the layers of complexity for most. We sat through countless meetings with our Congressional and IRS friends when we looked at this more than a decade ago, and what you realize is that the clear lines between service providers and sellers of goods has long become blurred. But even for those most clearly sellers of goods, the complexity of the tax accounting necessary to get the tax revenues to the government sooner than later have just continued to burden small businesses.

Unfortunately, it is an illusion to call cash accounting simplicity without reducing the inventory accounting burden. Again, it is important to bear in mind; the government ultimately gets its revenue. This is not about reducing the tax liability of these small businesses.

As to the proposed $10 million ceiling on cash accounting, the $10 million number has been a remarkably consistent benchmark over decades that has withstood the test of time. It continues to ensure the vast number of small businesses will never have to worry about a transition from cash to accrual. There are very few small businesses that ever cross the threshold. We are sure we can find a way to ease the transition when it does happen. It is not like it happens in an instant. A business can plan for coming up on the ceiling.

BUSINESS TAX SYSTEMS UNIFICATION

While we keenly value the fact most small business owners are taxed only once on their business income, small business is constantly whipsawed between the focus on large multi-national C Corporations and high income individuals. We would be tempted to say small business is painted with the same brush in these debates. Whether the topic is the estate tax, top marginal rates and myriad of business deductions and credits, small businesses are frequently painted, ironically, with two brushes at the same time, with the large corporations and with the high-income individuals. We would prefer if we had our own brush.

In addition to being able to focus on what is good for small business, if we could move to a unified business tax system that is bifurcated along the size of business, we could do amazing things to simplify the tax responsibilities of small business. We could address the need for the myriad deductions and credits and many of the administrative rules that attempt to distinguish various types of tax-related activities.

To that end, we support the modest steps proposed in the draft without indicating a preference for one or the other of the two proposals to move the S Corporation and partnership worlds into a more unified structure. Our only concern is that in the small business community, it is not uncommon for small business partners to allocate income based on factors such as experience and business acumen notwithstanding a "50-50" ownership structure. We hope the new system accommodates that concern.

We know there are going to be some challenges such as the issue of withholding on the net income of owners. We have never been enamored with withholding and recent experiences have only reinforced our reservations but we approach this process with an open mind.

At the end of the day, however, we need to move towards the unification of business tax structures. There will be thousands of reasons why we should not. A fair and simple tax system is the reason why we should.

Thank you.

The Small Business Legislative Council is a permanent, independent coalition of more than 50 trade and professional associations that share a common commitment to the future of small business. Our members represent the interests of small businesses in such diverse economic sectors as manufacturing, retailing, distribution, professional and technical services, construction, transportation, and agriculture. Our policies are developed through a consensus among our membership. Individual associations may express their own views